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Bao Ngoc Dinh

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performance of listed companies

Dinh Bao Ngoc



Unité Mixte de Recherche CNRS / Université Pierre Mendès France Grenoble 2
150 rue de la Chimie – BP 47 – 38040 GRENOBLE cedex 9
Tél. : 04 76 63 53 81 Fax : 04 76 54 60 68



The impact of Sovereign Wealth Fund investments on the performance of listed companies

Dinh Bao Ngoc¹

In this study, we attempt to shed some light on the effects of SWF investment activities by analyzing the short-term impact of SWF investments on the performance of those companies in which they invest. We collect both direct and indirect data on equity investments for each SWF. The sample consists of 60 investments by 11 important SWFs from around the world (SWF of the United Arab Emirates, China, Kuwait, Russia, France, Singapore...) during the period 2003 to 2009. To quantify the valuation effects of SWF investments, we use the event study methodology to estimate abnormal returns to the shares around the times that news of the transactions of SWFs becomes publicly available. We find that the announcement effect of SWF investments in listed companies is positive and the level of transparency of SWFs influence the positive impact of SWF investments on the performance of those companies in which they invest.

Keywords: Sovereign wealth funds, performance, event study.

1. Introduction

Sovereign Wealth Funds (SWFs) offer a variety of economic and financial benefits. SWFs are special investment funds created or owned by a government to hold foreign assets for long term purposes. Their rapid growth in recent years has prompted concern among economists. Yet, there has been very little academic research in this domain. Recently, the popular press and the general public have both become extremely active in discussing the potential impact of SWFs.

Several empirical studies find the positive impact of SWF investments on the values of the companies in which they invest (Chhaochharia and Laeven, 2008; Fotak, Bortolotti and Megginson, 2008); Kotter and Lel, 2008; Dewenter, Han and Malatesta, 2009...). However, some economists worry about the investments of SWFs. It may be that the market reacts negatively to the announcements of SWF investments. This argument assumes that SWFs may impose the goals and the priorities that are not consistent with the maximization of the profitability of firms, creating a high agency costs and a fall of the firm value.

Taking account of these contradictions, we analyze the impact of SWF investments on the performance of the firms. However, because of the difficulty in collecting the data, we consider only the immediate impact of SWF investments on the performance of the firms. We seek to test whether the effect of SWF investments in

¹ Dinh Bao Ngoc, 3rd PhD Student, CERAG, University Pierre Mendès France, France
Email: dinhb@upmf-grenoble.fr

companies on balance creates or reduces value by examining the returns to target firm shareholders subsequent to these investments. Our results are consistent with those of the previous studies. They contribute to the empirical studies that confirm the positive impact of SWF investments on the performance of the companies.

Firstly, a literature review resume the results of the previous researches that examine the market reaction to announcements of investments by SWFs. After that, we explain the methodology and the data of our research. Finally, the empirical results and the conclusions about the impact of SWFs investments on the performance of the companies are presented.

2. Literature review

SWFs are defined as special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. The SWFs are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatizations, fiscal surpluses, and/or receipts resulting from commodity exports. (International working group of SWFs – IWG).

There has been some empirical research to examine the impact of SWFs investments on firm values. Chhaochharia and Laeven (2008) show that the announcement effect of SWFs investments in listed equities is positive. They find that share prices of firms respond favorably when SWFs buy stakes, in part because these investments happen when firms are in financial distress. However, the long-run performance of equity investments by SWFs tends to be poor, coherent with imperfect portfolio diversification and poor corporate governance. Fotak, Bortolotti and Megginson (2008) obtain similar results about the announcement effect of SWFs investments. In fact, they consider that stocks of targeted firm exhibit positive abnormal returns when the SWF investments is announced and they explain this as evidence that investors appear to welcome SWFs. Their results document that the greater the share of the firm acquired by the SWF and the greater the level of transparency of the funds itself, the positive reaction is stronger. They also find that SWFs are associated with deteriorating firm performance over two years subsequent to the initial SWF investment. They conclude that SWFs have a negative impact on firm profitability in the long term, perhaps by imposing additional agency costs.

Kotter and Lel (2008) show that the market reacts positively to announcements of investments by SWFs, because of SWFs investments in firms facing financial difficulties and the information generation of stock selection by the funds. They also find that the degree of SWF transparency is related to the market reaction. However, they document that SWF investments do not significantly impact target firms profitability, growth and governance in the three-year following the investment. Dewenter, Han and Malatesta (2009) find positive market reactions to acquisitions announcement and negative to divestment announcement of SWFs. In a long-term analysis, the hypothesis that stocks bought and sold by SWFs earn normal returns afterwards is not rejected. However, the results in the long-run in the studies of Nuno

Fernandes (2009) and Sojli Tham (2010) are different with the previous. In fact, Nuno Fernandes (2009) finds that firms which have higher SWFs ownership have higher firm valuations and better operating performance and SWFs contribute to create long-term shareholder value. Sojli Tham (2010) also finds that in the short-term, the markets welcome SWFs investments and in the long-term the level of internationalization and Tobin's q of the firms increase substantially after SWF investments.

We find that several studies examine the impact of SWF investments on the values of the companies but don't analyse clearly the influence of the level of transparency of SWFs on the market reaction to the announcements of SWFs investments. In this study, the principal hypothesis that we want to test is : The market reacts favorably to the announcements of SWFs investments and the level of transparency of SWFs influence the positive reaction of the announcement of the SWFs acquisition on the share prices of the companies.

3. Data and Methodology

To quantify the valuation effects of SWF investments, we use the event study methodology to estimate abnormal returns of the shares around the times that news of the transactions of SWFs becomes publicly available. For these transactions, we searched both the Factiva and Lexis Nexis new source databases to obtain the announcement dates. The final sample consists of 60 investments in listed companies by 11 important SWFs of 6 countries around the world during the period 2003 to 2009.

Table 1: Sovereign wealth funds and the number of observations

Sovereign Wealth Funds	Number of observations
Government of Singapore Investment Corporation (GIC)	14
Temasek Holdings – Singapore	10
China Investment Corporation (CIC)	9
Strategic Investment Fund – France	9
Abu Dhabi Investment Authority (ADIA)	5
SAFE Investment Company – China	4
Kuwait Investment Authority (KIA)	3
Qatar Investment Authority (QIA)	2
Investment Corporation of Dubai (ICD)	2
Dubai World Holdings Ltd –UAE	1
Mubadala Development Company - UAE Abu Dhabi	1
Total	60

After selecting a sample for our study, we collected the data necessary to perform an event study methodology. Using the Datastream database, we obtained the daily stock price of target firms to calculate the return of the company. For the return of the market, the price index (PI) of market calculated by Datastream was used.

The following steps are taken for implementing the event study:

- **Identification of the event window**

We examine different event windows $[t - 10, t + 5]$, $[t - 3, t + 3]$, $[t - 1, t + 1]$, $[t + 2, t + 10]$... over the period $[t - 40, t + 20]$. Let $t = 0$ represent the time of the event.

- **Determination of a expected return of the security i for time t during the event window in the absence of the event (K_{it})**

We use a simple market model to estimate coefficient α and β of firms:

$$R_{it} = \alpha_i + \beta_i R_{Mt} + \epsilon_{it} \quad t \in I_N$$

For each event, the market model is estimated over the period 400 to 50 trading days prior to the event date.

Then, the expected return K_{it} is estimated for time t during the event window:

$$K_{it} = \alpha_i + \beta_i R_{Mt} \quad t \in I$$

- **Calculation of the abnormal return within the event window**

We calculate the abnormal returns by differencing the observed return R_{it} and the expected return K_{it} :

$$AR_{it} = R_{it} - K_{it}$$

- **Calculation of the average abnormal return (AAR) and the cumulative average abnormal return (CAAR):**

Given N events (a total of 60 in the entire sample), the sample average aggregated abnormal return for period t is:

$$AAR_t = \frac{1}{N} \sum_{i=1}^N AR_{it}$$

The average abnormal return can then be aggregated over the event window to calculate the cumulative average abnormal return for each firm i :

$$CAAR_{t1,t2} = \sum_{t=t1}^{t2} AAR_t$$

- **Testing whether the abnormal return is statistically different from 0**

We use Student's t -test to test whether the average abnormal return and the cumulative average abnormal return are statistically different from 0.

To analyze whether the level of transparency of sovereign wealth funds influence the relation between stock returns and sovereign wealth funds investments, we use also the event study methodology for three groups of samples depending on the level of transparency. This new approach helps to analyze clearly the influence of transparency of SWFs on the market reaction to the announcements of SWFs investments, for which the previous studies didn't pay attention.

4. Empirical results

Table 2 presents the average abnormal returns for the event window $(-10, 10)$. The results indicate that, at the date $t = -1$ and $t = 0$, the AAR is significantly positive. These results show that the relations between the stocks return and sovereign wealth funds acquisitions at the announcement date is positive.

Tableau 2: Average Abnormal Return and the Student's t-test

Date	AAR (%)	CAAR (%)	t -test -AAR	Pr > t
-10	-0.29616	-2.95100	-0.96	0.3391
-9	0.106775	-2.84423	0.34	0.7356
-8	-0.13847	-2.9827	-0.47	0.6396
-7	0.74032	-2.24238	1.72*	0.0909
-6	0.23375	-2.00863	0.68	0.5010
-5	0.07940	-1.92923	0.25	0.8057
-4	0.19096	-1.73827	0.57	0.5685
-3	-0.61818	-2.35645	-2.61	0.0114
-2	0.26896	-2.08749	1.27	0.2108
-1	0.59304	-1.49445	1.96*	0.0548
0	0.67257	-0.82188	1.73*	0.0885
1	-0.03616	-0.85803	-0.09	0.9258
2	0.18735	-0.67069	0.49	0.6242
3	-0.21956	-0.89025	-0.61	0.5412
4	0.63060	-0.25965	1.70*	0.0938
5	0.50138	0.24173	1.51	0.1352
6	0.11925	0.36098	0.45	0.6513
7	-0.14534	0.21564	-0.54	0.5937
8	-0.06967	0.14597	-0.22	0.8259
9	0.19337	0.33934	0.66	0.5138
10	0.25838	0.59772	0.67	0.5025

* represent significance at the 10%

The Table 3 reports the cumulative average abnormal return for different event windows over the period (t - 40, t + 20). The results indicate that sovereign wealth funds investment generate substantial and positive CAAR during the two trading days before and after the announcement of the investment. The average five-day cumulative abnormal returns are 1.69 percent for a (-2, +2) window and 1.23 for a (-1, +1) window. It means that around the announcement date, the impact of sovereign wealth funds investment on the performance of companies is positive.

Tableau 3: Cumulative Average Abnormal Return and the Student's t-test

Event windows	CAAR (%)	t -test - CAAR
(-40,-20)	-0.71331	-0.64
(-20,-10)	-2.42401	-2.38
(-10,-5)	0.72561	0.92
(-5,2)	1.33795	1.24
(-3,3)	0.84802	0.90
(-2,2)	1.68576	1.98*
(-1,1)	1.22945	1.84*
(2,10)	1.45575	1.26
(-20,10)	1.12471	0.53
(10,20)	0.07251	0.05
(-40,20)	0.41185	0.13

* represent significance at the 10%

We find that our results support the hypothesis proposed : the market reacts favorably to the announcements of SWFs investments. They are consistent with the previous studies that conclude the announcement effect of sovereign wealth funds investment in companies is positive. Ours estimates of announcement period CAAR for the investment sample exceed those of Chhaochharia & Laeven (2008) and Fotak, Bortolotti & Megginson (2008). The former study reports a CAAR of 0.82 percent for a (-2, +2) and 0.55 percent for a (-1, +1) window. However, our results are lower than those of Kotter & Lel (2008) and Dewenter, Han & Malatesta (2009). The results of these authors present a CAAR of 2.43 percent for a (-2, +2) and 2.15 percent or 1.7 percent for a (-1, +1) window.

Table 4: Results of the previous studies

Authors	Event windows	CAAR (%)
Chhaochharia & Laeven (2008)	(-2, 2)	0.82
Fotak, Bortolotti & Megginson (2008)	(-1, 1)	0.55
Kotter & Lel (2008)	(-2, 2)	2.43
	(-1, 1)	2.15
Dewenter, Han & Malatesta (2009)	(-1, 1)	1.7

We can see the charts of the AAR and CAAR over the period (t - 40, t + 40):

Chart 1 : Average Abnormal Return (%)

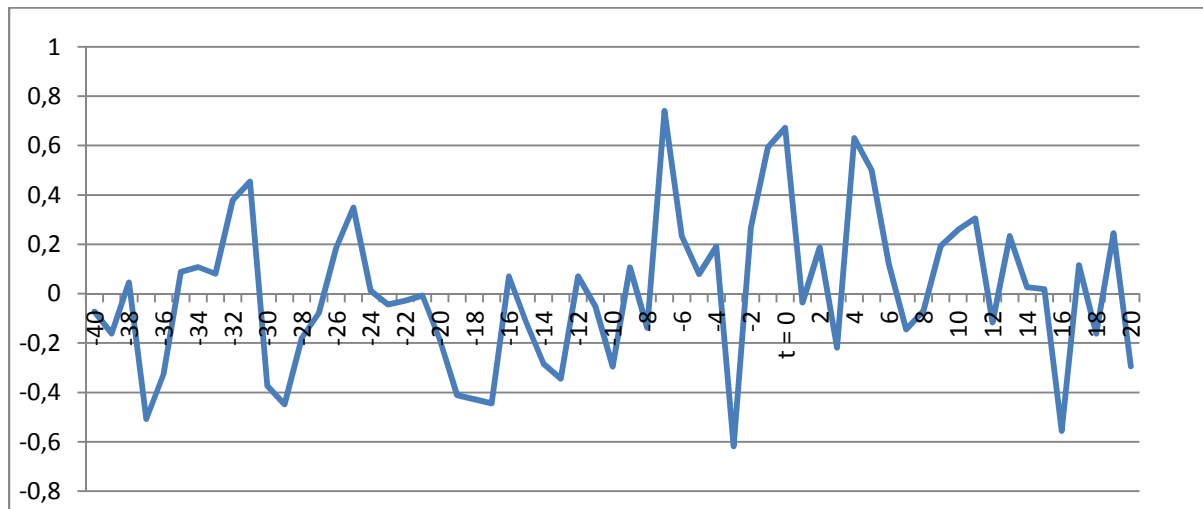
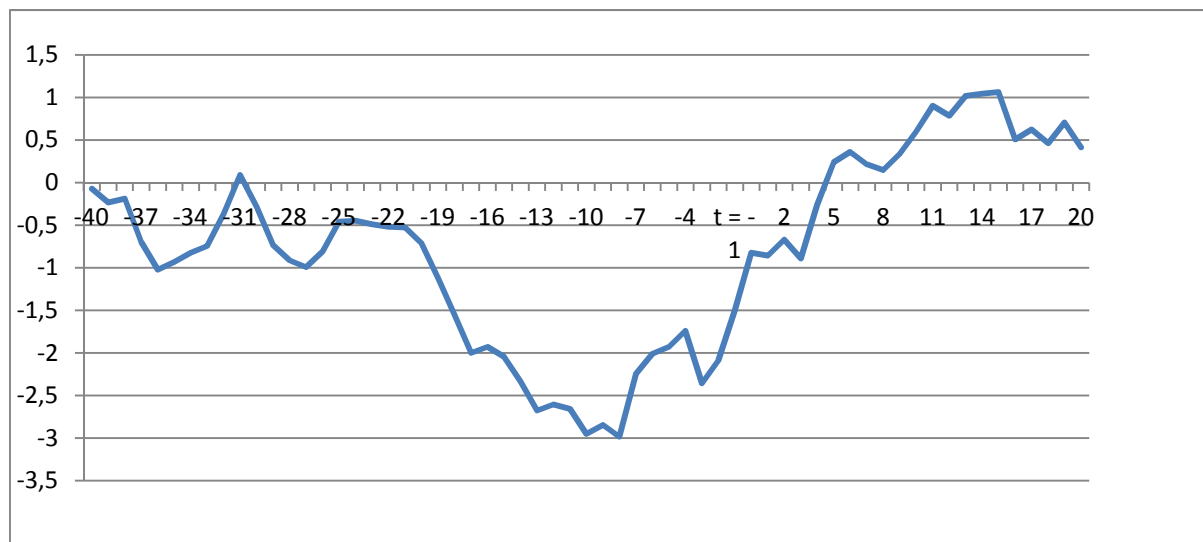


Chart 2 : Cumulative Average Abnormal Return (%)



- **Transparency of SWFs and the impact of SWF investments on the performance of the companies**

We continue to analyze whether the level of transparency of sovereign wealth funds influence the positive relation between stock returns and sovereign wealth funds acquisitions at the announcement date. We group and examine the investment of sovereign wealth funds having different level of transparency. We use the index Linaburg-Maduell of the Sovereign Wealth fund Institute as a measure for the transparency of sovereign wealth funds.

We divide the sample into three groups depending on the level of transparency:

Group 1: Investment of sovereign wealth funds having the high transparency (from 8 to 10)

Group 2: Investment of sovereign wealth funds having the normal transparency (6 and 7)

Group 3: Investment of sovereign wealth funds having the low transparency (less than 6)

Table 5: Transparency of the sovereign wealth funds and the sample

Sovereign wealth funds	Linaburg -Maduell (9/2008)	Linaburg -Maduell (9/2010)	Number of observations
Temasek Holdings – Singapore	8	10	10
Mubadala Development Company - UAE Abu Dhabi	7	10	1
Group 1 (from 8 to 10)			11
Government of Singapore Investment Corporation	6	6	14
China Investment Corporation (CIC)	6	6	9
Kuwait Investment Authority (KIA)	6	6	3
Group 2 (6 and 7)			26
Qatar Investment Authority (QIA)	5	5	2
Investment Corporation of Dubai	4	4	2
Abu Dhabi Investment Authority	3	3	5
SAFE Investment Company – China	2	2	4
Group 3 (less than 6)			13
Dubai World Holdings Ltd –UAE	N/A	N/A	1
Strategic Investment Fund – France	New	New	9
Total			60

We use the event study method and the same steps for the new sample of three groups.

Tableau 6a: Average Abnormal Return and the Student's t-test - Group 1

Date	AAR (%)	CAAR (%)	t -test -AAR	Pr > t
-5	-0,52482	0,53740	-1.10	0.2983
-4	0,64396	1,18135	1.02	0.3300
-3	-0,18158	0,99977	-0.57	0.5810
-2	1,13218	2,13196	2.30**	0.0441
-1	0,95798	3,08994	1.03	0.3251
0	1,72780	4,81773	1.69	0.1214
1	2,08645	6,90419	1.66	0.1283
2	-1,46580	5,43839	-0.98	0.3483
3	1,43372	6,87211	1.67	0.1256
4	0,62607	7,49818	0.62	0.5485
5	0,72134	8,21952	0.65	0.5283

Tableau 6b: Average Abnormal Return and the Student's t-test - Group 2

Date	AAR (%)	CAAR (%)	t -test -AAR	Pr > t
-5	0,72559	-1,83021	1.15	0.2618
-4	0,37356	-1,45665	0.55	0.5876
-3	-0,58865	-2,04530	-1.25	0.2230
-2	-0,03440	-2,07969	-0.10	0.9229
-1	0,60386	-1,47584	1.15	0.2629
0	0,61650	-0,85934	1.02	0.3186
1	-0,83092	-1,69026	-1.79*	0.0861
2	0,50510	-1,18515	0.95	0.3506
3	-0,44149	-1,62664	-0.72	0.4753
4	0,65993	-0,96671	0.97	0.3391
5	0,41007	-0,55664	0.83	0.4168

Tableau 6c: Average Abnormal Return and the Student's t-test - Group 3

Date	AAR (%)	CAAR (%)	t -test -AAR	Pr > t
-5	-1,01164	-5,21472	-2.72**	0.0186
-4	-0,53309	-5,74781	-1.32	0.2122
-3	-0,52739	-6,27520	-1.76	0.1033
-2	-0,03971	-6,31491	-0.11	0.9117
-1	0,47070	-5,84421	1.06	0.3117
0	0,75353	-5,09068	0.88	0.3944
1	-0,82219	-5,91287	-1.24	0.2400
2	0,87692	-5,03595	2.09*	0.0588
3	-0,80160	-5,83755	-1.17	0.2648
4	0,83744	-5,00011	1.28	0.2253
5	0,31082	-4,68929	0.46	0.6530

At the date $t = 0$, the AAR of the three groups are positive. However, the AAR and the value of Student's t-test of group 1 is the most highest ($AAR_{t=0G1} = 1.73\%$; $AAR_{t=0G2} = 0.62\%$) and $AAR_{t=0G3} = 0.75\%$) ; ($T_{t=0G1} = 1.69$; $T_{t=0G2} = 1.02$ and $T_{t=0G3} = 0.88$). These results indicate that the relation between the stock returns and the sovereign wealth funds acquisitions at the announcement date is positive. However, greater the level of transparency of SWF, the signification of this relation is higher ($Pr > |t|_{t=0G1} = 12.14\%$; $Pr > |t|_{t=0G2} = 31.86\%$ et $Pr > |t|_{t=0G3} = 39.44\%$).

The charts below present the average abnormal return and the cumulative average abnormal return of the three groups:

Chart 3a: Average Abnormal Return - Group 1 (%)

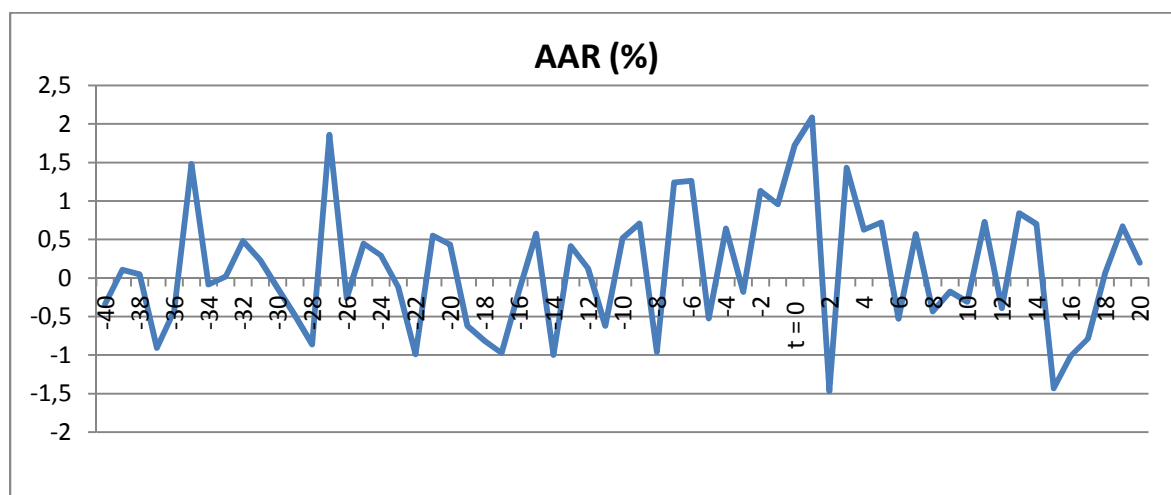


Chart 3b: Average Abnormal Return - Group 2 (%)

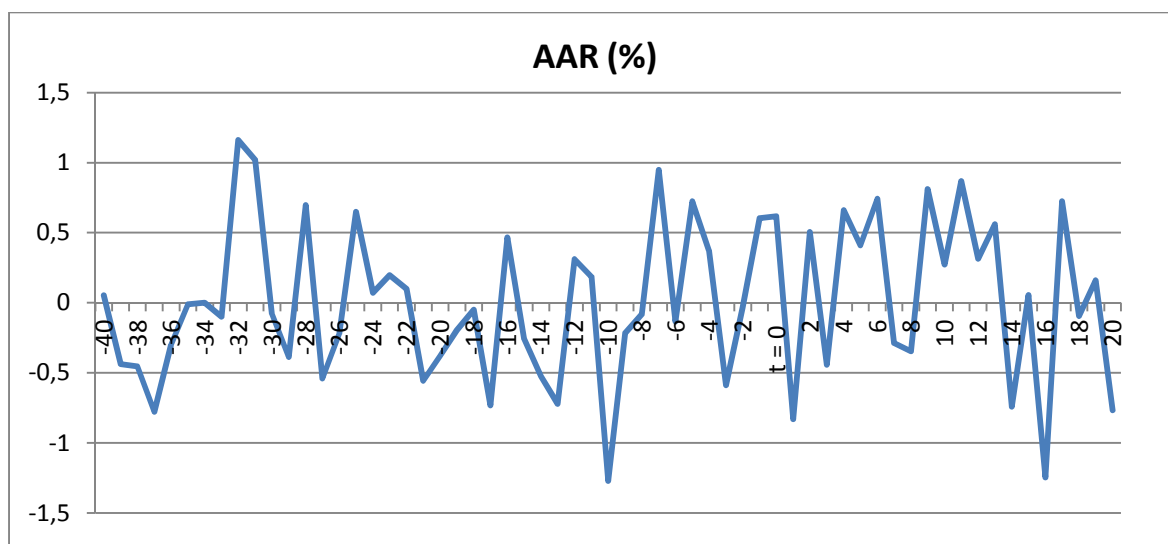


Chart 3c: Average Abnormal Return - Group 3 (%)

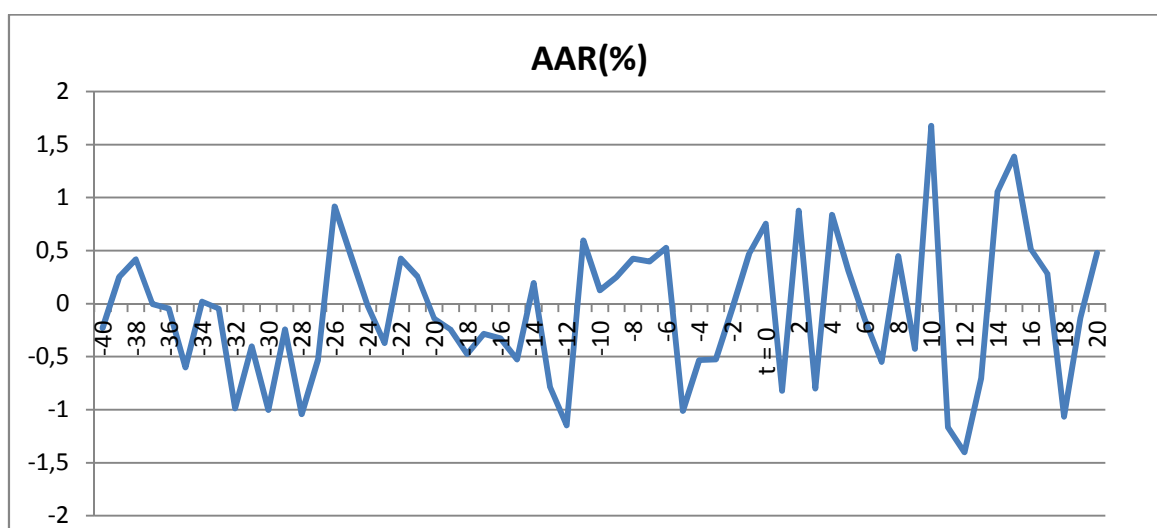


Chart 4a: Cumulative Average Abnormal Return – Group 1 (%)

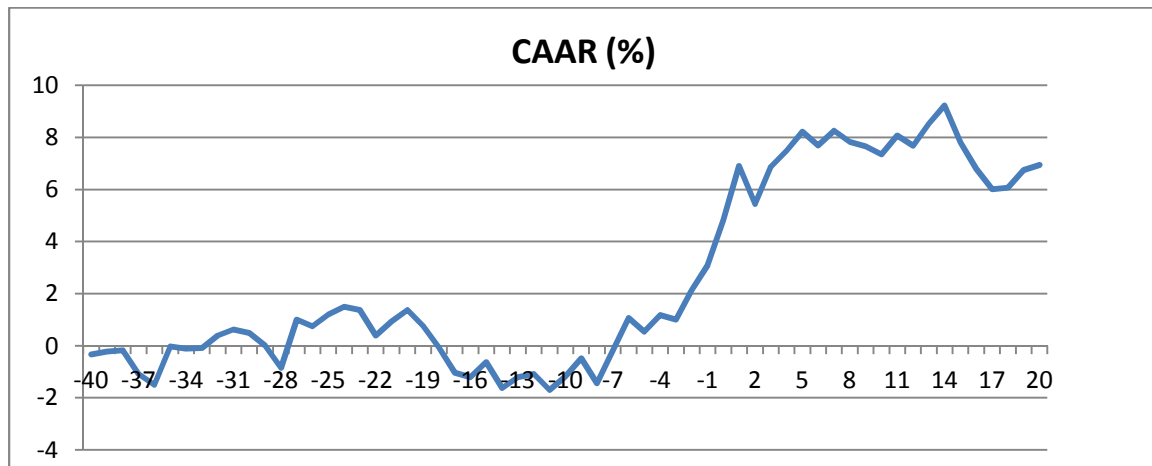


Chart 4b: Cumulative Average Abnormal Return – Group 2 (%)

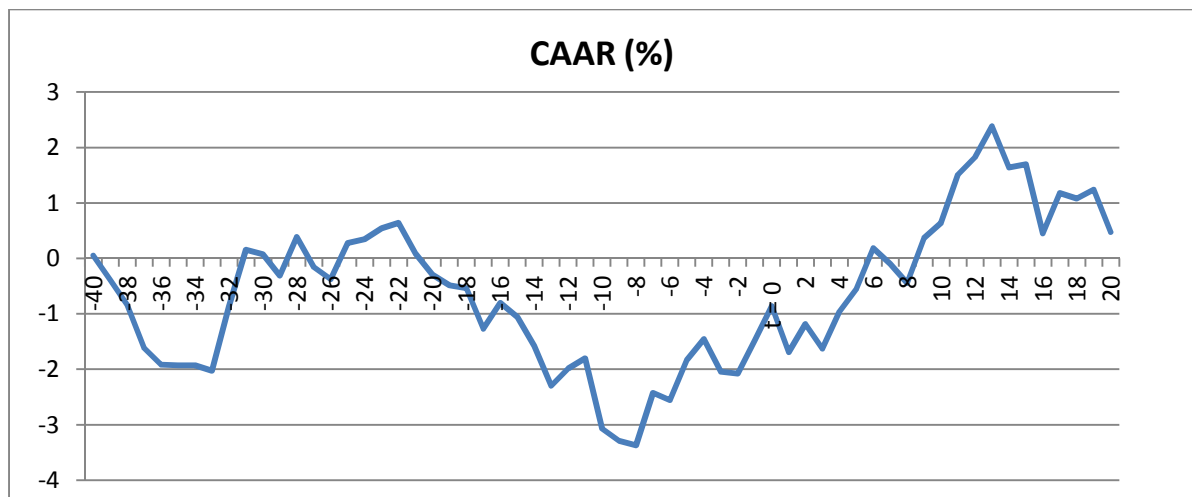
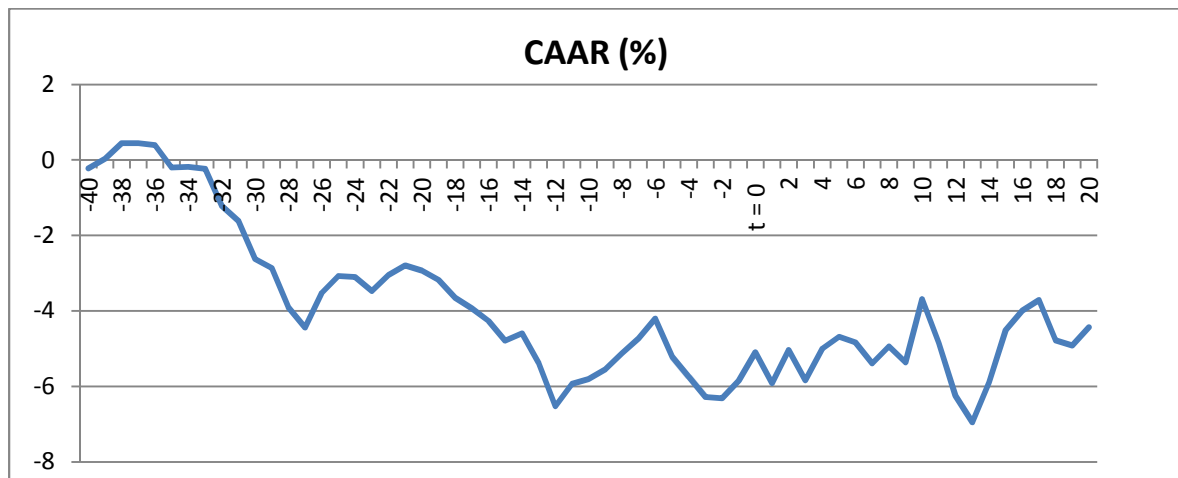


Chart 4c: Cumulative Average Abnormal Return – Group 3 (%)



The results of the CAAR of three groups are very different. The tendency of the CAAR of Group 1 increase 6 days before the announcement date. The tendency of the CAAR of Group 2 increase 9 days after the announcement date and the tendency of the CAAR of Group 3 keeps on decreasing.

We also calculate the CAAR and the Student t-test for different event windows over the period (t-40, t+20):

Tableau 7: Cumulative Average Abnormal Return and the Student's t-test for 3 groups

Event windows	Group 1		Group 2		Group 3	
	CAAR (%)	t -test	CAAR (%)	t- test	CAAR (%)	t -test
(-40,-20)	1,37289	0,58	-0,29171	-0,19	-2,93082	-1,82
(-20,-10)	-2,12540	-0,82	-3,15850	-2,10	-3,01036	-1,86
(-10,-5)	2,24332	1,91	-0,02803	-0,02	0,71382	0,78
(-5,2)	4,37617	1,04	1,37064	0,91	-0,83287	-0,70
(-3,3)	5,69076	2,50**	-0,16999	-0,11	-0,08974	-0,05
(-2,2)	4,43861	1,33	0,86014	0,72	1,23925	1,32
(-1,1)	4,77223	2,19*	0,38944	0,48	0,40204	0,35
(2,10)	0,44310	0,12	2,33132	1,55	2,22700	0,83
(-20,10)	6,41150	0,93	0,55492	0,20	-0,89513	-0,18
(10,20)	-0,71430	-0,27	0,10799	0,05	0,93126	0,28
(-40,20)	6,94201	1,10	0,47562	0,08	-4,43285	-0,57

For the Group 1, the results of CAAR and Student t-test show that the CAAR for 7 days (-3, +3) and 3 days (-1, +1) is significantly positive (signification at the 5% and 10%). For the Group 2 and Group 3, around the announcement date, the CAAR for the 5 days (-2, +2) and 3 days (-1, +1) are positive. However, these values are low and Student t-test does not indicate that the CAAR for these event windows are significantly different with 0.

Comparing the results of the sovereign wealth funds having the high transparency (Group 1) with those having the normal and low transparency (Group 2 and Group 3), we find that in the announcement date, the AAR of Group 1 is the most highest and this value decreases with the level of transparency of sovereign wealth funds. Around the announcement date, the CAAR of Group 1 is higher than that obtained in the case of Group 2 and Group 3.

These results indicate that the level of transparency of sovereign wealth funds influence the positive reaction of the announcement of the sovereign wealth funds acquisition on the share prices of the companies.

5. Conclusion

Recently, sovereign wealth funds has prompted concern among economists, however, there has been very little academic research in this domain. We seek to test whether the effect of SWF investments in companies on balance creates or reduces value by examining the returns to target firm shareholders subsequent to these investments. By dividing the sample into groups depending on the level of transparency, we analyze clearly the influence of transparency of SWFs on the market reaction to the SWFs investments, which was not focused in previous studies.

We find that the short-term impact of SWF investments on the performance of the companies in which they invest is positive. The level of transparency of SWFs influence the positive impact of SWF investments on the performance of those companies and the greater the level of transparency of SWF, the positive reaction is stronger.

We hope that this study will enhance current understanding of SWF impact on the subsequent performance of the listed companies in which they invest and contribute to improve the performance of SWFs and of the firms that attract SWF investments.

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